REDACTED VERSION

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

The Berkshire Gas Company	)))	D.T.E. 02-19

INITIAL BRIEF OF
THE BERKSHIRE GAS COMPANY

I. OVERVIEW

A. Summary of the Petition

On April 5, 2002, The Berkshire Gas Company ("Berkshire" or the "Company") filed a petition pursuant to G.L. c. 164, §76 and §94A for approval by the Department of Telecommunications and Energy (the "Department") of: (i) the Gas Portfolio Optimization Agreement between the Company and BP Energy Company ("BP Energy") dated as of March 25, 2002 (the "Portfolio Agreement"); and (ii) the Gas Sales and Purchase Agreement between the Company and BP Energy dated as of March 25, 2002 (the "Purchase Agreement"; the Purchase Agreement and the Portfolio Agreement are referred to collectively as the "Agreements"). The Agreements extend and modify the terms of an "alliance" structure pursuant to which Berkshire shall continue to pursue a variety of opportunities to secure gas cost savings for the benefit of customers. The alliance was originally established pursuant to a Gas Portfolio Optimization Agreement dated March 30, 2001 and a Gas Sales and Purchase Agreement dated March 30, 2001 between the Company and BP Energy (the "2001 Agreements"). The 2001 Agreements were approved by the Department in The Berkshire Gas Company, D.T.E. 01-41 (June 29, 2002).

The Agreements preserve the fundamental structure of the approved alliance. First, Berkshire shall continue to control and manage its existing and approved gas supply, transportation and storage resources, seeking to build upon its increasing experience in managing its resources to generate gas cost savings for the benefit of its customers. Second, Berkshire shall continue work with its affiliated local distribution companies (New York State Electric & Gas Corporation ("NYSEG"), Connecticut Natural Gas Corporation ("CNG") and The Southern Connecticut Gas Company ("SCG"; NYSEG, CNG and SCG are referred to collectively as the "LDCs") to generate savings that have been made available by mergers involving Energy East Corporation. Finally, Berkshire and the LDCs have agreed to continue to work with BP Energy to pursue additional value through transactions that may be generated or identified by BP Energy or through the application of BP Energy's substantial expertise and resources.[1] The alliance team will continue to coordinate their activities in an attempt to optimize or manage the combined portfolios and to build upon the achievements of the initial alliance term. Importantly, a detailed audit analysis confirmed that the alliance's procedures and controls are "reasonable and are functioning as intended." Exh. DTE 1-8 (Suppl.), p. 3.

NYSEG, CNG and SCG executed agreements with BP Energy that are substantially identical to the Portfolio Agreement and the Purchase Agreement. Exh. AG-19.[2] The term of the Agreements is for the period between April 1, 2002 through March 31, 2004.[3]

[1] The Portfolio Agreement continues to provide that BP Energy will consult with the Company on a day-to-day basis. Cf. Berkshire Gas, D.T.E. 01-41. As the Company will still be implementing optimization or capacity management transactions, the margin sharing provisions of D.P.U. 93-141-A continue to apply directly to alliance savings. See, SRR-DTE-1 (Suppl.). Thus, the Company expects to continue to share such margins with customers pursuant to established standards.

[2] Berkshire executed an interim agreement with BP Energy to cover the period from April 1, 2002 through the time for requisite regulatory approval. Exh. AG 1-19. Berkshire understands that the portfolio agreement and purchase agreement for NYSEG did not require the approval of the New York Public Service Commission to be effective. SRR-DTE-1. The portfolio agreements and purchase agreements for CNG and SCG were considered by and a final decision approving the agreements was issued by the Connecticut Department of Public Utility Control ("DPUC") on July 24, 2002. Application of Connecticut Natural Gas Corporation and the Southern Connecticut Gas Company for Approval of Gas Portfolio Optimization Agreements, Docket No. 01-04-04.

B. Description of the RFP Process

Berkshire has demonstrated that the Agreements are the product of its continuing and diligent effort to provide reliable, least-cost service to customers, including the issuance of appropriate competitive solicitations to secure beneficial resources and services. As the Department has noted, local distribution companies are under a continuing obligation to seek ways in which to optimize the value of their gas supply resources and to minimize the cost of those resources for customers. NOI-Gas Unbundling, D.T.E. 98-32-B, pp. 58-59. Over the last several years, Berkshire has pursued a variety of techniques in order to secure value and to reduce the cost of gas service for customers. These efforts included individual, limited term arrangements and the execution of an asset management contract that was approved by the Department in Berkshire Gas Company, D.T.E. 99-81 (1999). See also, Tr. 298-299. In early 2001 Berkshire built upon its substantial, direct experience with a variety of optimization alternatives and, at the same time, evaluated the gas resource synergies that were available because of the then recent mergers with Energy East. The combined resource portfolios of Berkshire and the LDCs were evaluated and opportunities to lower costs or extract value were identified and considered. The expanded resources available because of such mergers made a wider range of savings or management opportunities available to the Company because of the more substantial internal expertise and the greater value that a larger, more diverse portfolio and geographically expansive service area provided. Cf. Boston Gas Company, et. al., D.T.E. 99-76, pp. 20-21 (1999). The Department found the 2001 solicitation to be transparent, fair and open.

[3] Several ancillary agreements were executed in connection with the alliance documents, including an Allocation Agreement that memorialized the procedures to be employed in terms of the allocation of savings generated within the alliance among the Company and the LDCs. See Exh. BG-1, Exhibit B-10. A Netting Agreement was also executed that memorializes certain payment or settlement procedures. Id. at Exhibit B-9. These ancillary agreements were included within the Portfolio Agreement and, accordingly, any approval of the Portfolio Agreement may constitute an implicit approval of these agreements. The Company has no objection if the Department explicitly approves these agreements.

Berkshire Gas, D.T.E. 01-41, p. 11. This successful solution resulted in the execution and approval of the 2001 Agreements.

The 2001 Agreements included a provision whereby the term of the alliance could be extended beyond the initial one-year term upon such modified terms and conditions to be developed during an exclusive negotiation period with BP Energy. See Exh. BG-3, §§ 3.2, 3.3; Tr. 359-60; Berkshire Gas, D.T.E. 01-41, pp. 13-14. The Department's order in D.T.E. 01-41 directed that, prior to renewing the 2001 Agreements for a consecutive term, the Company should "issue a new RFP and . . . demonstrate to the Department that renewing the [2001 Agreements] would likely produce benefits to Berkshire that would equal or exceed other marketing offerings." Berkshire Gas, D.T.E. 01-41, p. 14. Berkshire and the LDCs elected to initiate discussions with BP Energy regarding an extension of the 2001 Agreements. Exh. BG-7, p. 7; Tr. 15-16. At the same time, in compliance with the Department's directive, Berkshire issued its own request for proposals ("Berkshire RFP") to secure Company-specific bids so that it might fully evaluate the merits of extending the alliance and comply with the Department's directives. Exh. BG-7, p. 7; Tr. 15, 359-60, 365-66; Exh. AG 1-15. In early December 2001, while awaiting responses to the Berkshire RFP and after substantial negotiation efforts with BP Energy, Berkshire and the LDCs elected to terminate negotiations with BP Energy with respect to continuing the alliance under the 2001 Agreements. Exh. BG-7, p. 7.

The Company nevertheless found the responses to the Berkshire RFP to be informative. The Company noted the limited number of responses to the Berkshire RFP and the disappointing proposals within such responses. Exh. DTE 1-3. Berkshire recognized that these limited bids reflected not only the changed market conditions but also the more limited value of the Company's resources on a "stand-alone" basis. Exh. BG-7, p. 8; Tr. 368-69; Exh. DTE 1-2. In order to attempt to secure the best opportunity for optimization or capacity management and consistent with the Department's findings on the merits of regular market solicitations, the Company elected to participate in a joint solicitation with the LDCs.[4]

Berkshire worked with the LDCs to develop and implement a fair, open and transparent competitive bidding process that was intended to secure proposals that would provide the greatest value to customers. These efforts culminated in the issuance of a request for proposals for optimization services for Berkshire, the LDCs and RG&E on December 21, 2001 (the "Joint RFP"). Berkshire determined that such a robust solicitation "was the best means to test the market to ensure that the most attractive proposal was pursued" and to comply with Department precedent.[5] Exh. BG-7, pp. 7-8; Berkshire Gas, D.T.E. 01-41, pp. 10-11; Berkshire Gas, D.T.E. 99-81, pp. 3-5; Boston Gas, D.T.E. 99-76, pp. 20-2. The Joint RFP and the related evaluation process were similar to the RFP and evaluation process that resulted in the 2001 Agreements. Again, the Department has specifically found that the substantially similar RFP process employed to establish the alliance in 2001 was fair, open and transparent. Berkshire Gas, D.T.E. 01-41, p. 11.

Eleven potential bidders were issued the Joint RFP. Exh. DTE 1-3. Ten bids were received and analyzed in detail and certain clarifications and enhancements were requested and secured. The nature of the solicitation was clear, potential bidders were afforded the opportunity to ask questions on the RFP and no bidders raised procedural or substantive complaints with the process. See Exh. DTE 1-3 (Suppl.); Exh. DTE 1-4; Exh. AG 1-15 (Suppl.). The responses to the Joint RFP reflected the changed market conditions since the initial solicitation of bids in

[4] Rochester Gas and Electric Company ("RG&E") participated in the Joint RFP. RGS Energy Group, Inc., the parent of RG&E had executed an agreement to merge with Energy East Corporation. RG&E ultimately elected to choose another energy supplier. Exh. BG-7, p. 8, n. 1.

2001 that established the alliance. As Ms. Zink explained, subsequent to the establishment of the alliance:

> [W]ellhead prices, transportation values and market spreads had diminished . . . . Also, the absence of Enron and changing market and financial conditions directly and indirectly reduced the number of energy companies that were qualified to work with the LDCs.

Exh. BG-7, p. 8. The quality of bids received in response to the Joint RFP had deteriorated noticeably from the time of the Berkshire RFP, a trend that is likely to have continued given current market conditions and events. Exh. AG-15 (Suppl.).

A comprehensive quantitative and qualitative evaluation was completed and detailed negotiations commenced with the proponent of the most favorable bid, BP Energy. Exh. DTE 1-4. The Department has previously endorsed gas company resource acquisition processes such as this involving the solicitation of competitive bids from alternative suppliers. Berkshire Gas Company, D.T.E. 98-110, p. 7 (1999); Colonial Gas Company, D.P.U. 96-48, pl 49 (1996); Holyoke Gas and Electric Light Department, D.P.U. 93-191, p. 30 (1996); Blackstone Gas Company, D.P.U. 95-15, p. 17 (1996); Fall River Gas Company, D.P.U. 94-38, p. 10 (1995). More specifically, the Department has approved and endorsed a very similar solicitation process in Berkshire Gas, D.T.E. 01-41.

The Company and the LDCs properly determined that the BP Energy proposal was superior to alternative proposals. The BP Energy proposal presented the best opportunity for the Company to manage its resources in order to reduce gas costs for customers. Exh. BG-7, p. 9; Exh. DTE 1-4; Exh. AG 1-15 (Suppl.). The Company was able to confirm this conclusion based upon an analysis of the results of two market solicitations. Specifically, the Company recognized that the alliance provided substantial benefits in a range of conditions. First, when

[5] The Company also determined that the best means to secure the most competitive proposal from BP Energy was to permit BP

gas prices are low and stable (and optimization opportunities are less available), the alliance provides for an increased guaranteed minimum savings payment. Exh. BG-7, pp. 6, 10-11; Exh. BG-1, Art. IV; Exh. AG 2-6; Tr. 335-36.[6] Alternatively, when commodity prices are higher and more volatile (and optimization or capacity management opportunities are more readily available), the alliance provides strong incentives to maximize savings with the Company and the LDCs receiving the benefit of nearly all savings generated through the alliance. Exh. BG-1, Art. III; Exh. BG-7. pp, 10-11 (The Company and the LDCs "are guaranteed an aggregate minimum level of savings… with [the Company and] the LDCs retaining most of the upside."). Thus, when the benefits of capacity management or optimization are most necessary, the alliance has been structured to place no limit on the savings to customers.[7]

Alternative proposals were simply not as attractive. Generally, alternative bids did not compare favorably in terms of price. Also, the consideration of non-price factors supported the BP Energy proposal. Exh. DTE 1-4; Exh. AG 1-15 (Suppl.); KeySpan Energy Delivery New England, D.T.E. 02-18 (2002). BP Energy, unlike many other players in the natural gas market, maintains a strong credit rating. In addition, the alliance structure does not involve the operational and control-related concerns associated with the insolvency of bankruptcy of an asset manager, an increasingly important concern in the rapidly changing natural gas marketplace. Berkshire has substantial experience working with asset managers and, thus, was well-suited to make this determination. See e.g.. Exh. AG 1-1; Tr. 14; Berkshire Gas, D.T.E. 99-81.

In addition, the Company and the LDCs recognized that a strong working relationship with BP Energy had been developed and that appropriate systems and controls had been

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Energy to bid in response to the Joint RFP. Exh. DTE 1-5.

[6] [INTENTIONALLY OMITTED]

[7] [INTENTIONALLY OMITTED] For example, there are no limits imposed on the storage activities that helped the Company to secure substantial savings during the initial term of the alliance. Exh. AG 1-2; Exh. AG 2-1.

established to ensure that alliance savings were calculated and allocated properly. Tr. 320-21; Exh. AG 1-15 (Suppl.); Exh. DTE 1-8 (Suppl.); RR-AG-8. Indeed, a detailed audit process, described below, confirmed the appropriateness of the alliance's procedures and controls. Exh. DTE 1-8 (Suppl.); RR-AG-8. The fact that the alliance has established appropriate procedures and controls during its initial term provides the Company substantial comfort with respect to future operations pursuant to the Agreements.

C. Description of the Agreements

The solicitation and negotiation process pursued by Berkshire and the LDCs has refined the previously approved alliance structure in a manner that will maintain reliability, not increase costs above the levels within gas supply contracts that have been previously approved by the Department (cf. Berkshire Gas, D.T.E. 01-40, p. 11 and Boston Gas, D.T.E. 99-76, pp. 17, 21) and provide the greatest opportunity for the generation of overall gas cost savings by exploiting the opportunities available through coordinated activities with affiliates and the substantial resources available through BP Energy.[8] The Portfolio Agreement ultimately established a refined incentive structure that achieves the Company's established objectives and aligns the interests of all the alliance parties. That is, maximum benefits for each party are achieved only when particular transactions also secure the maximum benefits for the other party. As described, the guaranteed minimum savings to the Company and the LDCs has generally been increased, and the Company's percentage of higher savings has increased thereby providing greater benefits when most necessary. Exh. BG-1, Art. IV; Exh. BG-7, pp. 10-11; Tr. 334-35. Importantly, and

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[8] Berkshire believes that the willingness of BP Energy to support the Company's petition in this proceeding through the testimony of key project officials demonstrates the commitment to secure benefits for Berkshire as well as the other LDCs. Cf. Exh. AG 15 (Suppl.). The audit efforts implemented by the Company and the LDCs confirmed that BP Energy is providing:

> [A] very good level of support for Alliance transactions . . . . [The Auditors'] contacts with people at BP Energy indicate[d] a high-level of commitment and willingness to meet our requests and the demands of the Alliance.

consistent with Department precedent, the Agreements also provide for enhanced document maintenance procedures beyond those generally found to be acceptable after a detailed audit. Exh. BG-1, Exhibit B-11; Exh. DTE 1-8 (Suppl.). These enhanced records, together with the establishment of a new "allocation team," will enable the Company, the Department or other stakeholders to more efficiently evaluate the results of the alliance transactions and the savings generated for the benefit of customers. Tr. 100-01; RR-DTE-3.

The related Purchase Agreement executed with BP Energy provides Berkshire with a least-cost, reliable and flexible resource and enables Berkshire to "fine tune" its supply portfolio to continue to reflect the previous termination of a more burdensome and expensive supply contract in 1999. See Berkshire Gas, D.T.E. 01-41, p. 12.[9] Berkshire indicated that limited quantities of gulf coast supplies would be purchased and that such gas could be purchased pursuant to attractive, flexible terms that were comparable, if not superior, to gas supply contracts available to Berkshire or the other LDCs. Berkshire Gas, D.T.E. 01-41, pp. 5, 12; Berkshire Gas, D.T.E. 98-110, pp. 5-6; Boston Gas Company, D.T.E. 99-76, p. 21 (1999); Berkshire Gas, D.T.E. 99-81, p. 4 (1999); NOI - Gas Unbundling; D.T.E. 98-32-B, pp. 59-60. The Purchase Agreement also reflected an enhancement from the 2001 Agreements whereby the Company now enjoys greater flexibility in the pricing of its gulf coast supplies. Exh. BG-1, §2.7; Exh. BG-4, §5.3. In sum, the Purchase Agreement furthers Berkshire's portfolio objectives of implementing a least cost supply strategy that maximizes flexibility and reliability and, therefore, is consistent with the public interest. Berkshire Gas, D.T.E. 01-41, pp. 11-12; see also Commonwealth Gas Company, D.P.U. 94-174-A, p. 27 (1996); Berkshire Gas Company, D.T.E.

RR-AG-8, p. F-1. See also Tr. 32-33 for a description of staff applied to the alliance by BP Energy.

[9] Berkshire also negotiated the right to undertake a competitive solicitation to address the replacement of existing gas supply contracts that expire in October 2002. See Berkshire Gas, D.T.E. 01-41, p. 12; Exh. BG-1, § 13.7.

98-99, pp. 38-39 (1999) (Berkshire's supply planning process seeks the development of a resource plan that provides safe and reliable service, including efforts to minimize short-term costs while maintaining long-term supply security); Berkshire Gas, D.T.E. 98-110, pp. 4-5.

The Purchase Agreement also enhances reliability in view of the resources of BP Energy, the largest producer and reserves holder of natural gas in North America. Tr. 33; Exh. BG-7, p. 4; Exh. DTE 1-32. The Purchase Agreement also contains favorable contractual provisions, e.g. the force majeure clause. Exh. BG-4, Art. XI; Exh. BG-1, Art. XIV; cf. Berkshire Gas, D.T.E. 01-41, p. 5. Accordingly, Berkshire has demonstrated that the execution of the Purchase Agreement, similar to the Gas Sales and Purchase Agreement dated March 30, 2001 in place for the initial term of the alliance, provides net benefits to customers and satisfies the Department's standards with respect to gas purchase agreements. Berkshire Gas, D.T.E. 01-41, p. 12.

In sum, the Company has demonstrated that, similar to the 2001 Agreements,: (i) the Portfolio Agreement satisfies the Department's standards under G.L. c. 164, §94A and G.L. c. 164, § 76 and, therefore, the Department's findings in NOI-Gas Unbundling, D.T.E. 98-32-B; and (ii) the related Purchase Agreement satisfies the Department's standards under G.L. c. 164, § 94A.[10] Berkshire is proud of the efforts it has undertaken with the LDCs to implement and refine a strategy that responds to Department directives and advances the opportunity to secure the greatest value for customers. Berkshire is pleased to have secured such an attractive deal given current market conditions and diminishing opportunities. In addition, Berkshire believes that substantial long-term benefits will inure to the Company through its participation in the alliance in the form of greater market awareness and expertise. RR-DTE-6; Tr. 313. While more difficult to quantify, these benefits are expected to be real and substantial. Berkshire looks forward to working with the LDCs and BP Energy to managing its resources in order to secure savings for its customers and remains committed to the pursuit of a least-cost gas resource portfolio.

II. PROCEDURAL HISTORY

Subsequent to the filing of the Company's petition, the Attorney General of the Commonwealth (the "Attorney General") filed notice of his intervention, the Division of Energy Resources (the "DOER") filed a petition for leave to intervene and KeySpan Energy Delivery New England filed a petition for leave to participate in this proceeding as a limited participant. The Department conducted a public hearing at its offices on May 24, 2002. At this hearing, the DOER's petition for leave to intervene and KeySpan's petition for limited participant status were granted. Evidentiary hearings were held at the Department's offices on June 24 and July 8, 2002. At the evidentiary hearings, the Company presented four witnesses: Karen L. Zink, Vice President of Marketing and Resource Planning for the Company; Kevin W. Bass, Trading Manager-East Region for BP Energy; John W. Hormell, Storage and Asset Manager for BP Energy; and Thomas W. Deering, Audit Supervisor for NYSEG.

The evidentiary record consists of numerous documentary exhibits, including the initial filing of the Agreements, prepared testimony of Ms. Zink and the Company's responses to information and record requests, as well as the sworn testimony presented at the hearings. The Hearing Officer established a briefing schedule requiring the filing of initial briefs on July 24, 2002. Reply briefs were directed to be filed on August 13, 2002 and, consistent with the Company's request for the expedited consideration of the Agreements, a decision is anticipated by September 4, 2002. See Company Initial Filing Letter, April 5, 2002; Exh. BG-l, § 13.3;

[10] In addition, the Agreements extend the alliance for a term that falls within the limits of the transition period established in

Conference Telephone call with the Hearing Officer, Assistant Attorney General and the Company's Counsel, July 9, 2002.[11]

III. THE RFP PROCESS SATISFIED RELEVANT DEPARTMENT STANDARDS

As noted, on December 21, 2001, the Company and the LDCs issued the Joint RFP to eleven marketers or suppliers who were determined by Berkshire and the LDCs to have the appropriate capability to provide asset management or other similar services. Exh. AG 1-15; Exh. D.T.E. 1-3. These entities were asked to submit bids for savings opportunities and the presentation of innovative options was encouraged. Exh. DTE 1-15, Joint RFP, p. 5. Nine of the eleven entities submitted proposals in response to the Joint RFP. Exh. AG 1-15 (Suppl.); Exh. DTE 1-3. The proposals submitted included a variety of alternatives, including asset management agreements, as well as the more innovative alliance structures. Certain bidders were asked to clarify portions of their bid, to provide more responsive proposals. Bidders were provided the opportunity to ask questions with respect to the Joint RFP. Coincidentally with the issuance of the Joint RFP, the Company and the LDCs began and subsequently completed a benchmarking process to assess the level of savings that they expected could be achieved by the own internal management of their portfolios. Exh. AG 1-15 (Suppl.). This benchmarking analysis was to be utilized as a basis for comparing bid proposals to ensure that any bid selected

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D.T.E. 98-32.

[11] The Company sought confidential treatment for portions of the Agreements, for a number of documentary exhibits and for portions of the evidentiary hearings that addressed competitively sensitive issues. The Company filed a motion for protected treatment with respect to the Agreements that was referenced in subsequent filings. The Company has also filed a list of protected materials and a supplement to such list. A second supplement is attached to this brief. The Company notes that its continuing ability to secure innovative and competitive bids for gas and gas-related services is dependent upon the confidence of bidders that competitively sensitive materials will be accorded confidential treatment. In addition, the Company executed confidentiality agreements with bidders to the Berkshire RFP and the Joint RFP and, therefore, has a contractual obligations with respect to such matters. Finally, the Company wishes to preserve the confidentiality of certain internal information in terms of disclosure to BP Energy. Similar materials with respect to the 2001 Agreements were accorded protected or confidential treatment by the Department. Berkshire Gas, D.T.E. 01-41, pp. 17-18. The Company also executed confidentiality agreements with the AG and the DOER with respect to this proceeding. The Company will not restate its arguments with respect to confidentiality in this brief. The Company notes its appreciation of the efforts of Department staff, the AG and the DOER to protect the competitively sensitive portions of the Agreements and the evidentiary record.

would result in a more advantageous return to the Company and the LDCs. Exh. AG 1-15 (Suppl.). After a comprehensive review of the bids was completed by the Company and the LDCs, several bidders were selected for purposes of further negotiations. Id.; Exh. DTE 1-4. During this period of negotiation, specific bid enhancements were pursued and obtained and the most attractive bid was then selected. Extensive due diligence was performed. Id. The Company is not aware of any procedural or substantive complaints that were raised by any of the bidders. Exh. AG 1-15. (Suppl.)

A proposal by BP Energy that modified the approved alliance was ultimately selected by the Company and the LDCs as presenting the most advantageous bid. A variety of price and non-price factors were considered. Exh. BG-7, pp. 10-11; Exh. DTE 1-4; Exh. AG 2-3; Exh. AG 1-15 (Suppl.). Extensive negotiations were pursued with BP Energy that resulted in the execution of the Agreements that reflected only limited modifications from the 2001 Agreements.

The Joint RFP and the Company's evaluation and negotiation processes were substantially similar to the procedures followed and approved with respect to the initial alliance documents. Moreover, Berkshire complied with the Department's directives regarding a Company-specific solicitation. Accordingly, the Department should find that the Agreements were the product of a fair, open and transparent RFP process consistent with the requirements of D.T.E. 98-32 and other Department precedent. Berkshire Gas, D.T.E. 01-41, p. 11; NOI - Gas Unbundling, D.T.E. 98-32-B, p. 55; Berkshire Gas, D.T.E. 99-81, pp. 3-4; Boston Gas, D.T.E. 99-76, pp. 20-21; Colonial Gas, D.P.U. 96-48, p. 49.

IV. THE AGREEMENTS ARE CONSISTENT WITH BERKSHIRE'S STATUTORY OBLIGATIONS AND DEPARTMENT PRECEDENT

A. Summary of the Agreements

The Portfolio Agreement implements the continuation of a unique and innovative approach to gas supply and procurement that imposes no additional risk on the Company or its customers. Cf. Berkshire Gas, D.T.E. 01-41, pp. 11-12 and Boston Gas, D.T.E. 99-76, pp. 17-21. The Portfolio Agreement provides for the continuation of a strategic alliance pursuant to which BP Energy will continue to consult with and assist the Company in the cost-effective utilization of the Company's natural gas supply, transportation and storage assets, and advise the Company on matters involving price risk management and market conditions. Exh. AG 1-19; Tr. 98-99.

The Company's Portfolio Agreement with BP Energy is designed to continue to produce additional savings over and above those levels achievable by the Company without BP Energy. Cf. Berkshire Gas, D.T.E. 01-41, pp. 11-12. Under this alliance, BP Energy will use its expertise, supplies, and financial tools to add value to the Company's transactions. Tr. 98-99; RR-AG-8.[12] BP Energy will assist the Company in optimizing its assets with the goals of reducing the commodity cost of gas and achieving least-cost routing. Exh. BG-7, pp. 4-5. [INTENTIONALLY OMITTED] Importantly, access to BP Energy's broad expertise and market knowledge will continue to assist the Company with respect to decisions related to reducing the commodity cost of gas.

BP Energy and the Company will continue to work together on a daily basis to further reduce commodity costs associated with delivery of gas volumes, storage fill, and transportation, while maintaining the level of reliability. See e.g. Exh. BG-1, Art. II; Tr. 98-99; Exh. AG 1-19;

Exh. AG 1-13. Importantly, Berkshire will retain control over its resources and remains committed to satisfying its mandate to provide reliable, least-cost service. Berkshire will continue to participate in daily discussions with alliance team members and continue to dispatch its resources based upon the best available information and internal planning. Tr. 98-99. Optimization or capacity management opportunities will continue to be identified and exploited through the combined expertise of BP Energy and the Company, and the use of the assets of BP Energy and the Company, to improve overall gas cost savings for the Company. Exh. BG-7, pp. 4-5; Tr. 320. The Company has also structured the Portfolio Agreement to ensure an appropriate guaranteed aggregate minimum benefit while also ensuring that BP Energy has a strong incentive to enhance the value of the Company's portfolios. Specifically, BP Energy must make a guaranteed payment to the Company and the LDCs at a higher level than pursuant to the 2001 Agreements while savings are shared pursuant to an appropriate, negotiated sharing structure. Exh. BG-7, pp. 10-11; Tr. 334-35. Thus, even if no savings are realized, BP Energy will make guaranteed payments to the Company and the LDCs under the Portfolio Agreement, and the Company will only pay BP Energy for the commodity cost of the gas purchased by the Company. Tr. 355-56; Exh. BG-1, Art. IV. This structure will ensure that BP Energy continues to maintain appropriate incentives to maximize the Company's savings and obtain natural gas at the lowest possible cost.

Under the Portfolio Agreement, the commodity cost of gas will be determined by utilizing least-cost routing of the gas and will rely upon production area indices, pre-existing contract prices, and actual pipeline variable costs to determine the delivered-to-citygate commodity cost of gas. Exh. BG-1, Exhibit B-2. In addition, the Company will have full access

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[12] The two-year term may facilitate additional management opportunities by permitting specific optimization strategies that extend beyond a one-year term. Exh. BG-7, p.11.

to gas storage to withdraw gas that has been injected at summer prices. Exh. BG-7, p 5; Exh. AG 1-2; Exh. AG 2-1. These approaches will allow the Company to continue to optimize or manage its purchasing decisions and take advantage of market price differentials. Indeed, these same techniques proved extremely effective during the initial term of the alliance securing substantial savings despite market and weather conditions that reduced the opportunities for optimization transactions. Exh. BG-7, p. 5; Exh. AG 1-2; Tr. 342-46.

The Company's experience with BP Energy for the past year has confirmed the merits of continuing the alliance. Exh. BG-7, pp. 9-10; RR-DTE-6. First, BP Energy's operational performance has been exemplary. Tr. 320-21. Second, the savings achieved during this interim period have been greater than the level of savings the Company could have expected to achieve under the relevant market conditions absent this alliance with BP Energy. Tr. 344-46. Again, market and weather conditions made optimization opportunities more difficult.[13] The alliance, however, will provide benefits to the Company's customers under a range of market conditions. The experience of this past year may, in essence, be considered a "floor" or low case for optimization or capacity management opportunities. Thus, at a minimum, the alliance can be expected to provide low case benefits consistent with alternatives considered in response to the Joint RFP, while preserving the "upside" for the benefit of the Company's customers. Exh. DTE 1-2; Exh. BG-7, p. 5; Tr. 334-35, 349-50. This flexibility confirms the merits of the alliance structure.

[13] Ms. Zink explained how optimization transactions fit within the Company's portfolio objectives. The Company's goal is to secure a least cost, reliable gas supply and not merely to maximize particular optimization transactions. The Agreements are nevertheless structured to provide for guaranteed minimum payments. Exh. BG-1, Art. IV; Exh. BG-7, pp. 10-11; Tr. 334-35. Thus, even during periods of low, stable prices, the Company expects to secure optimization benefits through the alliance. More importantly, the incentive structure within the Portfolio Agreement ensures that maximum optimization savings will be secured for the benefit of customers when most needed, namely periods of high or volatile prices. Alternative structures, such as asset management arrangements, do not enable the Company to achieve this same portfolio objective.

The Company's collective savings realized by this strategic alliance with BP Energy will be determined in accordance with §4.2 of the Portfolio Agreement (Exh. BG-1) as clarified in the Allocation Agreement among the Company and the LDCs. Tr. 69-73. BP Energy will maintain, and the Company will have full access to, the record of all transactions entered into under the Portfolio Agreement. Exh. BG-1, §2.3; Tr. 97. All transactions will be recorded at the date of execution and such information will be available to Berkshire in "real time." Tr. 97. Enhanced reporting requirements have been reflected in the Portfolio Agreement. Exh. BG-1, Exhibit B-11. As confirmed in the Allocation Agreement, the Company's and each of the LDCs' individual share of the savings realized under the Portfolio Agreements will be, to the maximum extent practicable, allocated to each company individually on a transaction-by-transaction basis. Exh. AG 2-18; Tr. 112. An enhanced "allocation team" process will provide for a more timely and well-documented allocation procedure to ensure that appropriate savings dollars continue to flow to the Company. Tr. 100-01; RR-DTE-3. The allocation team will analyze each transaction and allocate savings based upon the nature of the transaction. Tr. 72-73.

B. Benefits of the Agreements

1. The Company Maintains Full Control Over Its Assets Under the Portfolio Agreement

Under the Portfolio Agreement, the Company will continue to control, own and operate its natural gas portfolios while accessing and leveraging BP Energy's extensive resources. Exh. BG-7, pp. 3-4. Importantly, many of these specific contracts have been approved by the Department and the overall resource plan has been considered in the forecast and supply plan review. See, e.g. Berkshire Gas, D.T.E. 01-41, p. 11; Berkshire Gas, D.T.E. 98-99. The Portfolio Agreement continues to provide the Company with the flexibility to manage its gas supply and procurement activities for the benefit of the Company and its customers. Exh. AG

1-2. This control reflects a substantially less risky strategy (with greater opportunities) than available pursuant to an asset management transaction. Tr. 350-51 [INTENTIONALLY OMITTED][14]

Berkshire will continue to maintain control of its dispatch decisions on a daily basis, as it has always done. Berkshire will continue to review weather forecasts, evaluate load requirements, storage inventories, market conditions, and conditions on the Tennessee Gas Pipeline to determine its dispatch requirements. Tr. 98-99. Reviewing these wide range of factors will enable Berkshire to continue dispatching gas to its customers on a least-cost basis. Once Berkshire completes this analysis, Berkshire will continue to participate in a daily conference call with the alliance team to review how much gas is required for the day and to discuss opportunities available to optimize the portfolio. Id.; RR-DTE-5. If necessary or appropriate, follow-up calls may be conducted during the course of the day. Tr. 98-99. Berkshire will remain able to monitor and review transactions on a daily basis to ensure that the needs of its customers are being carried out. This monitoring and reviewing capability will ensure that Berkshire's customers are being provided with least-cost gas and the maximum optimization or capacity management opportunities available to them. Exh. BG-7, pp. 8-10; Tr. 97.

The Portfolio Agreement implements an alliance that remains fully consistent with and enhances the Company's traditional gas supply strategy and portfolio objectives. See Berkshire Gas, D.T.E. 01-41; Berkshire Gas, D. T. E. 99-110; Berkshire Gas, D. T. E. 98-99, pp. 38-39.

[14] Given the increasing number of bankruptcies and insolvencies in the industry, the Company believes that is the far preferred course to maintain full control over its resources. The Company submits that the Department should fully consider the contraction of the market in evaluating the Agreements. See, e.g. Exh. BG-7, pp. 6-7. Berkshire believes that the alternatives to the alliance have diminished both in quantity and quality since the issuance of the Berkshire RFP and the Joint RFP. Berkshire would most likely not have any practical optimization alternatives for the upcoming winter were the Agreements not approved.

Under the Portfolio Agreement, the Company will: (i) retain full control of and access to its current gas supply, transportation and storage assets, as well as all downstream resources such as liquefied natural gas; (ii) have continued access to pricing under existing lower priced supply contracts; and (iii) purchase gas at production area pricing indices, without any requirement to use market area pricing indices. Exh. BG-7, p. 10-11. In sum, the alliance has been structured to maximize benefits in a variety of market conditions consistent with the Company's portfolio objectives.

Accordingly, the Department should find that the continuation of the alliance pursuant to the terms of the Agreements is consistent with the public interest.

2. The Portfolio Agreement Provides the Maximum Opportunity for Savings

The record demonstrates beyond challenge that the Agreements and the alliance structure reflected therein provide the most meaningful opportunity for generating the maximum level of savings or benefits for customers, particularly when optimization or capacity management is most necessary or beneficial. The Agreements provide for a higher guaranteed minimum payment than under the 2001 Agreements. Exh. BG-1, Art. IV; Exh. BG-7, p. 11. Berkshire concedes that under extreme and unusual circumstances, it is conceivable that Berkshire will generate less than its share of the guaranteed minimum payment. However, Berkshire's own benchmarking analysis, plus the experience from the initial term of the alliance, suggest that this scenario is not a likely outcome. See, e.g. Tr. 356-57; Exh. AG-15 (Suppl.). Further, the merits of securing an alternative structure such as an asset manager are increasingly diminished. The increasing depth and breadth of Berkshire's and the LDCs' experience suggests that there should be a sharing of optimization benefits and less of a need to "turn over the keys" to an asset

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Again, Berkshire submits that the continuing strength of BP Energy in the face of the adverse market changes confirms the merits manager. In addition, asset management arrangements provide greater risk given the assignment of control to third parties at a time of decreasing financial stability of asset managers. Exh. BG-7, p. 6.[15] In sum, the Agreements are likely to provide benefits to the Company equivalent to the best alternative bid when market conditions are not favorable. Exh. DTE 1-2. Alternatively, when greater optimization opportunities arise, the alliance will result in substantially greater benefits for customers as the Company and the LDCs' retained nearly all of the valuable "upside" on savings. Exh. BG-1, Art. IV; Tr. 350.

Berkshire has determined, based upon the extensive analysis performed in the RFP process, that the alliance structure provides the greatest "overall" opportunity for the Company to fulfill its portfolio objectives and the directives of the Department in D.T.E. 98-32. Berkshire respectfully submits that the analysis of the prospect of various outcomes and the relative opportunities performed in the RFP process that resulted in the decision to pursue the alliance structure with BP Energy was an exercise in effective and prudent resource planning. Accordingly, the Department should find that the alliance structure provides the best opportunity for the Company to secure a least-cost gas portfolio for the benefit of customers.

3. The Portfolio Agreement Imposes No Additional Risks on the Company or Its Customers

The Portfolio Agreement requires that the purchase price of natural gas will be at the lowest available marginal commodity cost. Exh. BG-7, pp. 9-10; Exh. BG-1, Art. XII. By its very terms, the Portfolio Agreement ensures that the Company pays no more for natural gas under the Portfolio Agreement than they would have in the absence of the Portfolio Agreement.

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of the Company's bid evaluation process and the Agreements.

[15] Conversely, BP Energy has maintained a strong financial structure while many participants in the natural gas market have recently encountered serious financial difficulties or retrenched their operations. Again, Berkshire has serious doubts as to whether any reputable firm would be willing to enter an alliance or asset management relationship with Berkshire Gas on a stand-alone basis at this time.

Exh. BG-1, Art. XII. As such, the Portfolio Agreement places no additional market risk on the Company or its customers. This feature was significant to the Department in its review of the 2001 Agreements and has been retained in the Agreements. See Berkshire Gas, D.T.E. 01-41, p. 11.

The Purchase Agreement provides that the Company will purchase natural gas at production area indices chosen by the Company - - a pricing methodology consistent with the Company's historical practice and accepted portfolio objectives. Id. The use of these market-based indices will ensure that gas is purchased on terms at least as favorable as the range of alternatives reasonably available to the Company. Commonwealth Gas Company, D.P.U. 94-174-A, p. 27. This approach, coupled with BP Energy's strong presence in the natural gas market described above will also maintain the Company's stellar reliability record. Cf. RR-DTE-6; (see also Exh. DTE 1-32). The Agreements also provide for greater purchasing flexibility for Gulf Coast gas by the Company than in the 2001 Agreements. Exh. BG-1, §2.7; Exh. BG-4, §5.3.

In addition, consistent with the fact that the Portfolio Agreement imposes no additional risks on the Company or its customers, the Company will not engage in any speculative financial arrangements under the Portfolio Agreement. Exh. BG-1, Exhibit B-3. While certain methods of reducing the cost of gas, such as injecting gas into storage during traditionally low cost months and withdrawing at average cost during winter months, as well as other physical transactions, may be deemed to be "hedging," they are, in fact, traditional cost reduction methodologies used by utilities to reduce the cost of gas to customers. These transactions are the means by which "savings" are secured. The Company will continue to comply with the relevant directives of D.T.E. 01-41 with respect to such matters.

Accordingly, the Department should find that the Agreements do not present any additional risk to the Company's customers.

4. Alliance Procedures and Contracts That Were Appropriate and Reasonable Have Been Enhanced.

The Company recognized that the alliance structure was complex and required substantial diligence in terms of the calculation of savings achieved as a result of alliance activity as well as the allocation of such savings among the Company and the LDCs. The Company and the LDCs implemented substantial procedures and controls with BP Energy to ensure that transactions were executed properly, that savings from alliance transactions were calculated properly and that savings were allocated properly. Exh. AG 1-3; RR-AG-5; RR-AG-8. The Company believes that the results of the alliance activities for the first year demonstrate that the initial procedures and controls were satisfactory. Exh. DTE 1-8 (Suppl.).

Specifically, the record demonstrates that transactions were executed on a daily and monthly basis without problem, reliability was maintained, if not enhanced, initial savings estimates that were later reconciled to relevant invoices were accurate and the Company and the LDCs benefited from sound procedures and reports. Exh. DTE 1-8 (Suppl.); RR-DTE-6; Tr. 320. Overall savings calculations were subject only to a minor year-end adjustment and allocations to the Company and the LDCs were made appropriately. Exh. DTE 1-8 (Suppl.).

Indeed, as part of the consideration of the renewal or extension of the alliance, the Company and the LDCs commissioned a comprehensive audit of alliance procedures and controls. An experienced internal audit team was organized. Tr. 177-78[16]. Detailed field work,

[16] The Company demonstrated that the decision to apply internal auditors to this task was reasonable and appropriate. The Company submits that the detailed audit workpapers demonstrate the diligence of the audit. See RR-AG-8. In addition, Energy East's external auditors are likely to review the audit report. Tr. 207. As a consequence, the Company will benefit from a second level of audit activity.

interviews and validation activities were performed. Tr. 179-84. While many potential audit techniques could have been employed, the alliance audit involved a comprehensive evaluation of all aspects of alliance activity for a particular month, September 2001.[17] This election enabled the auditors to examine and review activities and transactions at a greater degree or depth.

This cost-effective internal audit (cf. RR-AG-9 and RR-DTE-7) generally confirmed what the alliance team had already recognized. First, "the procedures and controls at BP [Energy] appear reasonable and are functioning as intended." Exh. DTE 1-8 (Suppl.). The audit process also confirmed that savings calculations were made correctly and payments between BP Energy and Berkshire and the LDC's were made in accordance with the 2001 Agreements. Id. Indeed, only a relatively minor adjustment of $5,500 was required after the detailed audit. Exh. DTE 1-8 (Suppl.); Tr. 188. Finally, the ultimately established allocation procedures allocated savings dollars to Berkshire and the LDCs in accordance with established allocation guidelines. Exh. DTE 1-8 (Suppl.)

The Company and the LDCs also shared some of the same limited concerns of the auditors. First, the Company recognized the need for more timely and complete documentation of alliance activity. Accordingly, the Portfolio Agreement was revised to include the specific and enhanced reporting requirements reflected in Exhibit B-11 to the Portfolio Agreement. The auditors later confirmed this concern in the limited area of allocation. Exh. DTE 1-8 (Suppl.);

[17] The audit team appropriately elected to review the alliance operations for a single month in substantial detail. Mr. Deering explained that, while other approaches could have been considered, the review of a single month had many advantages. In particular, because of the numerous reports and calculations required, the audit team determined that "by taking one month and following the transactions through from the initiation of the transaction into the reports, we would get a much better understanding of how [the alliance] processes work, to be able to validate the savings and optimization dollars." Tr. 190. The month of September 2001 was selected for a variety of reasons. The audit team wanted to review a month later in the process when refined procedures were in place. Id. at 189. Second, final billing adjustments were available for September 2001. Id. Third, September reflected a representative range of transactions. As Mr. Hormel explained, "the type of transactions were very typical, and the transportation book was a typical month" and transaction volumes were "average". Tr. 80, 134-35. While September 2001 reflected what higher than normal "savings" from storage activity, this result is based upon the fact that certain financial positions settled in September. Tr. 216-17. This factor was not, however, determinative as the audit team was more focused on procedures and controls and there were an appropriate range of transactions for the month.

Tr. 188. Berkshire is confident that the negotiated enhancements to reporting procedures will only enhance an already satisfactory process. Second, the auditors raised a concern with respect to the allocation of savings in the earliest or "transition" months of the initial term of the alliance. The auditors recognized that it would be appropriate to re-examine allocation calculations employing the refined techniques that were implemented for most of the initial term. Id.; Tr. 188-89. The Company and the LDC's agreed to this limited "double check" and such tasks are expected to be completed in early August 2002. RR-AG-6.[18]

In sum, while the Company is confident that appropriate procedures and controls have been established for the alliance, the Agreements reflect enhanced terms and conditions. Specifically, reporting procedures will be more detailed and allocation activities will be done on a more regular basis. The alliance team also will benefit from the past year's working experience in terms of not only optimization strategy, but also reporting and coordination requirements. RR-DTE-6. Accordingly, the Department should recognize these enhanced procedures and find that the procedures and controls to be implemented pursuant to the Agreements are reasonable and appropriate.

V. CONCLUSION

In summary, the Company has demonstrated that the Portfolio Agreement and the Purchase Agreement will provide benefits to Berkshire's customers in the form of lower gas costs while enabling Berkshire to continue to provide safe, reliable service. Based on the

[18] The Attorney General suggested that this limited follow-up activity somehow suggests that the Department should stay its review of this proceeding. Tr. 383-85, In fact, such argument is wide of the mark. The audit confirmed that the allocation procedures and controls were refined and appropriate by approximately August 2001 and that such procedures and controls employed through the remainder of the alliance's initial term were adequate and reasonable. Exh. DTE 1-8 (Suppl.). These same "refined" techniques were to be the basis of the enhanced allocation team to be implemented pursuant to the Agreements. The older, discarded allocation techniques employed in the early or "transition" months that are being reexamined in the follow-up to the final audit report have no hearing on the merits of the Company's petition in this proceeding. If anything, such follow-up only demonstrates the extreme case applied by the Company and the LDCs in terms of savings and allocation calculations.

foregoing, the Company respectfully requests that the Department take such actions as may be necessary and appropriate and issue an order approving the Agreements pursuant to G.L. c. 164, §§76 and 94A.

Respectfully submitted,

THE BERKSHIRE GAS COMPANY

By its attorneys,

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